A taxing issue

SDLT Peter Steiner and Ben Fryer consider recent decisions on perceived abuse of SDLT sub-sale relief

Schemes designed to avoid or reduce the payment of stamp duty land tax (SDLT) are coming under increasing scrutiny. The March 2012 Budget announced a raft of measures in relation to SDLT, notably to tackle SDLT avoidance in relation to high-value residential property transactions.

The perceived abuse of SDLT "sub-sale relief" has emerged as a key area of focus. A recent decision, *Vardy Properties Ltd and Vardy Properties (Teesside) Ltd* v HMRC [2012] UKFTT 564 (TC), represents a victory for HMRC. In *Vardy*, the SDLT scheme under review relied on SDLT sub-sale relief and was used extensively; reports suggest that the decision could save more than £170m for the Exchequer.

What is SDLT sub-sale relief?

The SDLT "transfer of rights" provisions (known as "sub-sale relief") were initially intended to relieve certain "intermediary" transactions (for example, involving housebuilders) from the effects of a double SDLT charge – first on buying the land and then when selling it on.

The sub-sale relief provisions apply where the completion or "substantial performance" of a contract for a land transaction between A and B (the "original contract") happens at the same time as, and in connection with, the completion or substantial performance of an assignment, sale or other transaction between B and C (the "transfer of rights"). The effect of the provisions is that the contract between A and B is disregarded so that there is no SDLT charge on B. Instead, there is a deemed contract (the "secondary contract") under which C is treated as the purchaser for SDLT purposes. The chargeable consideration under the secondary contract is the aggregate of:

- the consideration under the original contract that is referable to the subject matter of the transfer of rights and is given (directly or indirectly) by C or a person connected with C; and
- the consideration given for the transfer of rights.

Vardy

The scheme in question worked as follows:

- Seller – A – agreed in principle to sell a property to an unconnected buyer – C.
- C incorporated a new unlimited company – B.
- The contract for the property purchase was entered into between A and B.
- Before the completion or substantial performance of the sale contract, C subscribed for shares in B for a cash sum slightly higher than the property purchase price.
- Following exchange of contracts, B reduced its share capital to a nominal amount (by special resolution of C), thereby creating a distributable reserve.
- B declared a final dividend *in specie* in favour of C of the property it had contracted to acquire from A, to be satisfied on completion of the property purchase.
- B completed the property purchase from A (using the cash sum subscribed by C).
- B paid the dividend *in specie* (the property) to C.

The taxpayer argued that the transfer from A to B benefited from sub-sale relief and that the dividend from B to C did not attract SDLT as there was no chargeable consideration given in connection with the dividend *in specie*.

HMRC argued that sub-sale relief did not apply to the combined transactions and that even if it did apply in favour of B, C would be liable to SDLT on the full consideration given for the property. It also argued shortly before the hearing that the dividend *in specie* was invalid as a matter of company law as B's directors had failed to justify the declaration of the dividend *in specie* by reference to initial accounts.

HMRC succeeded in its last-minute argument that the dividend *in specie* was invalid as a matter of company law owing to an absence of accounts to justify the declaration of the dividend. Therefore, C did not acquire a valid entitlement to call for the conveyance of the property to it and, on this basis, the sub-sale provisions were not engaged.

The First-Tier Tribunal went on to consider the position under the sub-sale relief provisions had the distribution been lawfully declared. Significantly, the First-Tier Tribunal rejected the taxpayer's argument that no consideration could be attributed as a matter of law to the secondary contract. Applying a "purposive" approach to the legislation, it was found that because the consideration for the sale came indirectly from C (ie by way of subscription for shares in B), C would have been treated as having paid the full amount of the consideration to A for SDLT purposes had sub-sale relief applied in favour of B. It is this analysis that has attracted widespread concern – by attributing chargeable consideration to parties in a sub-sale structure (not necessarily only by virtue of a connection between the parties), HMRC may now have a basis for attacking bona fide sub-sale transactions.

HMRC consultation on sub-sale relief

On 17 July 2012, HMRC published a consultation paper with a view to reforming the "transfer of rights" rules. The reforms under consideration include making both B and C subject to SDLT, with relief only being available for B in specific circumstances and subject to certain conditions (eg where it is clear there is no tax avoidance purpose in relation to a relevant transaction). It is proposed that changes will be introduced in the Finance Bill 2013, although it has been suggested that any new rules may be brought in with retrospective effect.

DV3 RS Ltd Partnership v *HMRC* [2011] UKFTT 138 (TC)

DV3 was an earlier decision of the First-Tier Tribunal in relation to SDLT sub-sale relief in favour of the taxpayer. The scheme in question concerned the interplay of SDLT sub-sale relief and the SDLT partnership provisions. The tribunal rejected HMRC's argument that because the sub-sale relief provisions required the contract between the seller and B to be disregarded, B never acquired the property and, therefore, C could not have acquired it from B. An appeal by HMRC against the decision of the First-Tier Tribunal was heard in July 2012 in the Upper Tribunal; the outcome of this appeal is expected shortly.

DOTAS

On 17 September 2012, the government published regulations to amend the SDLT disclosure of tax avoidance scheme (DOTAS) rules. Avoidance schemes making use of the SDLT sub-sale relief provisions may need to be disclosed to HMRC under the new rules.

Comment

The government and HMRC are determined to tackle the perceived abuse of the SDLT sub-sale relief provisions. However, the boundary between "abusive avoidance" and "responsible planning" may not always be clear-cut and so developments in this area will be followed with interest. It should also be noted that both *Vardy* and *DV3* concerned facts that arose before a specific SDLT anti-avoidance provision dealing with "stepped" transactions (including sub-sales) – section 75A Finance Act 2003 – became effective. A case that tests the scope of section 75A is awaited to deal with the uncertainty in this area.

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